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A Two-Part Report: A and B

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EPA Releases Upbeat White Paper

By now the story is a familiar one: Japan's economy has shaken off the adverse effects of the high yen and is showing continuing vigor almost three years after the currency began a sustained rise. But the Economic Planning Agency, in 'ts 1988 economic white paper released in early August, points out that a year ago few expected such a favorable result. At that time, growth was slow, and EPA was expecting only a modest improvement. Many private economists thought EPA too optimistic.

The rest, of course, is history. For the fiscal year that ended March 31, the economy grew a real 4.9 percent. While exports were sluggish, domestic demand was buoyant, helped along by sizable increases in government spending and cuts in taxes. Falling net exports reduced the overall growth rate by 1 percentage point, but private domestic demand pushed it up by 5.5 points and government spending added another 0.5 point.

(distribution) contracts. Both changes could lead to higher imports and lower consumer prices.

OECD has many allies in its emphasis on microeconomic issues. Tax reform, of course, is one of Prime Minister Noboru Takeshita's highest legislative priorities. Washington has given notice that the next round of bilateral talks with Japan will put a heavy emphasis on Japan's competition policy and distribution system. Keidanren, the powerful Japanese business group, has pushed for a fundamental overhaul of Japan's regulatory structure. In an effort to head off repeal of the Large Retail Store Law, the Ministry of International Trade and Industry, however, is reportedly planning to substantially revamp or eliminate the administrative guidance actions that it takes under the statute -- starting with a requirement that large stores consult with the local community before starting construction.

For the Japanese individual, these developments suggest that international pressures are reaching further and further into the fabric of Japanese life. If the proposals are implemented, the changes could be dramatic. Prices on hundreds of everyday items could drop and variety expand. Modifications in the distribution system could affect hundreds of neighborhoods where small shops have flourished under the protective umbrella of government regulation. Washington, OECD and large Japanese business groups seem to be saying that these changes are long overdue.

Douglas Ostrom

Foreign Direct Investment In Japan Stays Strong

Underscoring the importance of a presence in Japan, foreign multinational firms boosted direct investment there in fiscal 1987 (ended March 31, 1988) despite the yen's appreciation against most major currencies. According to the Ministry of Finance, a record $2,214 million poured into the country compared with $940 million the previous fiscal year. This 135.5 percent increase far outweighed the 16.5 percent rise in the value of the yen compared to the dollar over the same period. The number of investments also jumped, increasing 28.2 percent from 3,079 in FY 1986 to 3,946 in the April 1987-March 1988 period.

By country (see Table 1), the United States remained far ahead of any other investor in Japan, with a 42.4 percent share in FY 1987. Although the U.S. share declined in FY 1987, the amount of investment nearly doubled from $488 million to $938 million; the number of investments also made a big jump. The other country showing a large increase was Switzerland, up 89.9 percent in value. (Investment from the Netherlands more than tripled in value, but this was mainly due to foreigners channeling funds through the Netherlands Antilles tax haven, not domestically generated money.) Reinvestment by Japanese subsidiaries of foreign firms made significant headway, with the number of investments rising 21.6 percent and the value increasing 165.9 percent. Finally, investors from smaller countries (probably Asian) were extremely active; their investments jumped 34.2 percent, and the total value went up 660.8 percent.

By industry (see Table 2), it is clear that foreign investors favored manufacturing activities; its share of total investment rose from 52.7 percent

Table 1: Foreign Direct Investment in Japan by Country, FY 1986-FY 1987

(in millions of dollars)

	FY 1986			FY 1987			Cumulative March 31, 1988		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
United States	489	$488	51.9%	684	$938	42.4%	6,245	$4,010	47.4%
Canada	88	2	0.3	118	4	0.2	490	127	1.5
United Kingdom	310	35	3.7	368	49	2.2	2,281	402	4.8
West Germany	179	47	5.0	237	53	2.4	1,422	347	4.1
France	173	17	1.8	180	20	0.9	1,376	164	1.9
Switzerland	220	89	9.5	311	169	7.6	1,555	565	6.7
Netherlands	179	19	2.0	269	78	3.5	1,031	259	3.1
Other Europe	170	28	3.0	199	79	3.6	1,404	285	3.4
Hong Kong	341	57	6.1	370	36	1.6	3,170	317	3.7
Japan*	305	85	9.0	371	226	10.2	2,647	1,347	15.9
Other	625	74	7.9	839	563	25.4	5,503	638	7.5
Total	3,079	940	100.0	3,946	2,214	100.0	27,124	8,460	100.0

*Investments by Japanese firms with significant foreign participation.

Source: Ministry of Finance

Table 2: Foreign Direct Investment in Japan by Industry, FY 1986-FY 1987

(in millions of dollars)

	FY 1986			FY 1987			Cumulative March 31, 1988		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
Manufacturing	1,563	$495	52.7%	1,505	$1,430	64.6%	12,907	$5,804	68.6%
Food	159	4	0.5	140	7	0.3	878	169	2.0
Textiles	31	19	2.5	3	0	0	142	50	0.6
Rubber and Leather	3	9	1.0	1	1	0	83	38	0.4
Chemicals	139	169	18.0	162	244	11.0	1,827	1,916	22.6
Petroleum	38	16	2.1	34	34	1.5	403	650	7.7
Nonmetallic Mineral Products	51	7	0.9	71	3	0.1	358	124	1.5
Metals	88	5	0.7	86	14	0.6	669	427	5.0
Machinery	834	232	24.7	803	1,110	50.1	7,156	2,176	25.7
Other	120	34	3.6	205	17	0.8	1,391	254	3.0
Nonmanufacturing	1,516	443	47.1	2,441	782	35.3	14,217	2,654	31.4
Construction	90	26	2.8	194	2	0.1	792	75	0.9
Real Estate	24	50	5.3	93	20	0.9			
Commerce	590	130	13.8	1,129	291	13.1	7,912	1,138	13.5
Services	467	47	5.0	652	181	8.2	3,567	392	4.6
Transportation	31	12	1.3	35	36	1.6	277	112	1.3
Communications	13	35	3.7	34	26	1.2			
Banking and Insurance	92	87	9.3	82	155	7.0	1,669	937	11.1
Other	209	56	6.0	222	71	3.2			
Total	3,079	940	100.0	3,946	2,214	100.0	27,124	8,460	100.0

Note: Totals may not add up due to rounding.

Source: Ministry of Finance

in fiscal 1986 to 64.6 percent in FY 1987. The machinery sector, in particular, received a much larger injection of cash from overseas, with just over half of all foreign direct investment directed toward it. The nonmanufacturing sector also attracted significantly more foreign money than in the previous fiscal year, but its rate of increase in value was less than manufacturing's (76.5 percent versus 188.9 percent). The sharp increase in the number of nonmanufacturing investments may hold the promise of stronger future growth since foreign firms may be testing the waters before deciding to commit significant resources. Foreign investors tried to take advantage of the upward spiral of land prices by quadrupling their stake in real estate. The construction and commerce fields also were active, each showing approximately double the number of investments.

The rising share of foreign purchases of warrant and convertible bonds is an important development in the overall pattern of foreign direct investment in Japan. The value of such "cash loan" investments skyrocketed in FY 1987, accounting for more than a third of the total value (see Table 3). In view of the rising popularity of these instruments among Japanese issuers and since these bonds may be exchanged for stock, MOF has separately listed cash loan flows since FY 1985. Cash loans are not included in the cumulative totals, however, since they remain bonds until converted into stock.

Table 3: Trends in Foreign Direct Investment in Japan, FY 1951-FY 1987

(number of cases and millions of dollars)

	Stock Acquisition		Cash Loans		Total	
Fiscal Year	Cases	Amount	Cases	Amount	Cases	Amount
1951-1980	8,826	$2,979	n.a.	n.a.	8,826	$2,979
1981	919	432	n.a.	n.a.	919	432
1982	1,052	749	n.a.	n.a.	1,052	749
1983	2,363	813	n.a.	n.a.	2,363	813
1984	3,685	493	n.a.	n.a.	3,685	493
1985	3,322	780	48	$150	3,370	930
1986	3,045	760	34	180	3,079	940
1987	3,912	1,453	34	761	3,946	2,214

Source: Ministry of Finance

More interesting, however, are the originators of these cash loans and their recipients. Of the $938 million that Americans invested in Japan, $335 million was in the form of cash loans. Only Switzerland ($71 million of $169 million) and the residual "Other" category ($353 million of $563 million) put similarly large shares into convertible and warrant bonds. By comparison, Japanese subsidiaries and British investors put no money into this form of investment, and most others put very little. West German investors, for example, put just $3 million of $53 million into cash loans. Of the $1,430 million channeled into the manufacturing sector, $603 million (42.2 percent) was in the form of cash loans. Just over half of all machinery sector investments consisted of this type ($560 million of $1,110 million). In contrast only $156 million (19.9 percent) of the $782 million directed at nonmanufacturing investments took the form of cash loans.

The overall growth of foreign direct investment in the face of the appreciating yen shows that foreign executives consider a Japan presence a necessary part of their global strategy. Perhaps more important, businessmen in small countries are also taking a more active interest in the Japanese market as shown by the sharp increase in investments from other countries. Many of these investments are probably made by South Korean, Taiwanese, Hong Kong and Singaporean businesses hoping to take advantage of the rising yen and strong domestic growth to increase exports to Japan. The restructuring of the Japanese economy may thus be encouraging foreign direct investment that will, in turn, aid the restructuring process.

Jon Choy

Senate To Consider South African Sanctions

The Senate Foreign Relations Committee will begin consideration of a South African sanctions bill (HR 1580) when the Senate returns from recess in early September. The legislation passed the House August 11 by a 244-132 margin. The bill would ban most trade between the United States and South Africa and would require U.S. investors to sell their holdings in South African companies. The new sanctions are an extension of those that Congress passed over a presidential veto in 1986.

The sanctions, though still popular with the public, do not have the same degree of support in Congress that they enjoyed in 1986, especially among Republicans. Congressional opponents to the new sanctions are not convinced that the ones already in place are effective. Some opponents believe that it is untimely to pass a new sanctions bill just prior to the inauguration of a new administration, which might be able to work out a more viable solution. Others feel that anti-apartheid policy is best served by supporting South Africa's black entrepreneurs via continued trade. In addition, it is not clear whether the sanctions legislation is compatible with the General Agreement on Tariffs and Trade.

An amendment was defeated in the House Ways and Means Committee that would have deleted a provision requiring the president to apply sanctions against foreign countries or companies that take "significant commercial advantage" of the United States' isolation of South Africa. If this provision remains in the legislation, it could have important ramifications for countries, such as Japan, that have strong trade ties with South Africa.

Since Japan took over from the United States as South Africa's leading trade partner in 1987, concerns about Japan-South African trade have been expressed. The Ministry of Finance attributed much of the 1987 increase to the appreciation of the yen; two-way trade was up 15 percent in dollar terms but only 2 percent in yen terms, according to MOF figures. The ministry recently announced that two-way trade figures for the three-month period, May-July 1988, showed that overall trade is declining. The Japanese government also has been encouraging Japanese businesses to lessen trade ties in order to quell international criticism.

The Japan Automobile Manufacturers Association, however, announced that car, truck and bus exports to South Africa were up 30.7 percent for the first

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REPORT

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JAPAN'S SOGO SHOSHA: BACK TO THE FUTURE?

Summary

While the strong yen and the restructuring of the domestic economy have affected all Japanese firms, Japan's general trading companies, sogo shosha, are particularly vulnerable. The sogo shosha were beginning to adjust their structure to the needs of post-industrial Japan when the Japan Economic Institute last examined their activities (see JEI Report No. 34A, August 31, 1984). The sudden and sharp appreciation of the yen, however, destroyed the assumptions that underlaid these first adjustment measures. Having learned some painful lessons, the trading companies have regrouped and now are striking out in new directions within traditional areas of activity.

Overview

There are over 1,700 trading companies in Japan, but only about 17 are considered sogo shosha. They merit the "general" aspect in several ways. The range of products handled by a sogo shosha is very broad, running from raw materials to finished products and from agricultural goods to high technology items. Most are involved in supply creation, investing in mining or production facilities overseas to insure and augment supplies. Each sogo shosha maintains a worldwide network of offices for gathering and handling trade, financial, technical and general economic data. This network not only allows sogo shosha to meet existing demand but also helps create trade opportunities. Geographic and product diversity allows innovative, imaginative deals to be arranged -- deals that would otherwise be impossible or unthinkable. The trade-financing abilities of sogo shosha are of far greater depth and breadth than those of smaller trading firms. Large-scale transactions or deals that would not qualify

for normal financing are not uncommon. Finally, their product and supply diversity gives general trading companies a cushion against a downturn in any one product. Their customers are also insulated from the sudden disruption of any one particular supplier since sogo shosha can usually compensate from other sources.

The sogo shosha continue to account for much of Japan's trade activity. The top six traders handled 50.6 percent of all Japanese trade in fiscal 1986 (ended March 31, 1987); the top four had a combined 33 percent of trade in FY 1987. In terms of exports, the six largest firms accounted for 42.9 percent of the total in fiscal 1986; the four biggest had 25.3 percent in fiscal 1987. Their share of imports was even greater: the top six firms bringing in 63.9 percent in FY 1986, and the top four handling 44.3 percent in FY 1987.

Their role in domestic economic activity is also significant. In terms of gross domestic product, the top six sogo shosha accounted for a combined 11.5 percent in FY 1986. The top four raised their share from 7.8 percent of GDP in fiscal 1986 to 8.1 percent the following year. Taking into account domestic and external activities, the combined sales of the five largest general trading firms were equivalent to 22.8 percent of Japan's total output of final goods and services (gross national product) in fiscal year 1987. To put these giants into better perspective, the gross turnover of any one of the major sogo shosha is double the sales of Toyota Motor Corp. (Japan's largest automotive maker) and three times the sales of Matsushita Electric Industrial Co., Ltd. (the country's largest maker of consumer electronics). Together the six largest firms have 277 domestic and 837 overseas offices, employing a global total of more than 61,000 people. This tally ignores the employment and output of each general trader's one to two dozen subsidiaries and affiliated companies. Sogo shosha are clearly mammoth organizations, behemoths that change direction only slowly.

A False Start

In each of the past three decades, "experts" have predicted the demise of the general traders when economic conditions gyrated wildly. The explosive growth of the 1960s, the oil shocks of the 1970s and the post-industrialization of Japan in the 1980s were all depicted as the beginning of the end for the giant traders. In the early 1980s doomsayers cited the following changes and predictions:

- Slower economic growth combined with conservation and rationalization plans would sharply cut Japan's raw material needs. The sogo shosha were supposed to whither away as demand dropped since these goods still make up a majority of their business.

- The demands of the burgeoning high technology sectors were beyond what the general traders could provide. As high technology spreads throughout Japan and the rest of the industrialized world, so the thinking went, the traders will be left behind.

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• Liberalization of domestic financial markets would eliminate the international edge that the sogo shosha had in trade and overseas finance, analysts worried. Japanese firms would have more options and flexibility to arrange their own financing, opening the way for foreign and domestic competitors.

In response, the general trading companies embarked on a series of maneuvers designed to keep them in step with the times:

• Increasing the amount of intermediate and higher value-added goods in their trade mix enabled the traders to build on their strength in handling commodities. As long as the item was needed in high volume and was available from a number of foreign sources, trading companies felt they could apply old practices to new products.

• Diversifying into new high technology areas was another priority. The companies felt that they could help small- and medium-sized foreign firms with top-quality, unique goods penetrate the Japanese market. Manufacturers of specialized computer systems and biotechnology firms were actively sought. By limiting the number of new high technology products, the traders felt confident that they could supply the after-sales support that is vital to success in the field.

• Expanding services trade and activities was also made a goal. Communications was selected as particularly suitable since the giant firms had a great deal of experience in global information networks. By seeking out foreign partners with well-established technology (mostly American operators of value-added networks), the sogo shosha hoped to capitalize on the deregulation of the domestic telecommunications market.

• Engaging in third-country trade, where both the buyer and the seller are non-Japanese, was the final component of their strategy. Using their experience and global contacts, the sogo shosha expected to become the world's trade middlemen.

The success of these four schemes in the first half of the 1980s varied widely from company to company, with only the last proving mostly successful. (The vote is still out, however, on the telecommunications ventures.) In general, critics were correct in arguing that the traders would move too slowly in fast changing markets, would be unable to successfully market the new products, would have trouble supporting state-of-the-art products, and lacked experience in most service areas. Given time, the companies could have overcome these deficiencies. The yen's sharp appreciation against the dollar and Tokyo's pledge to cut reliance on exports and boost domestic demand, however, presented an entirely new set of problems. The traders' attempts to cope with the first problems became moot.

New Rules of the Game

Since most trading company revenue is derived from foreign trade, it is not surprising that the yen's rise against most major currencies shook the general traders to their foundations. With most contracts denominated in dollars, sogo shosha watched helplessly as the yen rose and already thin profit margins

dwindled. Moreover, since trade contracts take several months to complete, the traders found it difficult to project exchange rates, although hedging in the foreign exchange market gave them some protection. Deals, therefore, were difficult to arrange.

More important was the rising yen's impact on the economy as a whole. On the one hand, the combination of the strong yen with low global commodity prices meant that the return on raw materials trading, always limited, was stagnant at best and often smaller. The pause in growth as firms adjusted to the high yen also meant dampened demand for many sogo shosha products, especially some of the new high technology equipment. Japanese manufacturing firms began to move operations offshore as production in Japan became too costly relative to nations such as South Korea and China. This posed a long-term threat to the general traders. Less production at home means restricted demand for the industrial inputs that are bread and butter to the sogo shosha.

On the other hand, the strong yen and the government's domestic demand stimulation policy opened the door to new growth options. The sogo shosha are well positioned to take advantage of the surge in imports generated by both the yen's greater buying power and the new emphasis on consumption. With their experience in exporting plant and equipment, the general traders also can offer advice and support to domestic firms interested in foreign direct investment. Finally, the stronger yen provides Japanese firms with more leverage to finance third-country trade and development.

New Strategies to Match

Chastened by the failure of numerous ventures in high technology products and services, the sogo shosha have recast their strategies to meet the new situation. At first glance, it would appear that the same tactics are being employed: modernizing traditional lines by adding high technology products; diversifying into new areas of goods and services; and becoming more involved in third-country transactions. Yet the new approach is more subtle and has new features.

- The general traders are adapting the old practice of supplying raw materials by commissioning the production of intermediate industrial products and consumer goods tailored to the Japanese market. Instead of simply buying what is available, sogo shosha are getting overseas manufacturers to produce textiles, apparel, food products, consumer appliances and industrial equipment that better match Japanese needs and tastes. In addition, many products can now be profitably imported thanks to the yen's appreciation.

Examples of this new approach abound, although the most striking is the surge in imports of low-end audio and video products from South Korea and Taiwan. Consumers are becoming more price conscious and open to non-Japanese manufactures, just as Japanese retailers and distributors are searching for products with better profit margins or unusual features.

Investment in foreign producers or production facilities is a variation of this theme as sogo shosha attempt to stimulate trade. This works in both directions by funding small- and medium-sized domestic and foreign firms that could not afford to export to or from Japan on their own. This tactic is used

across a wide range of industries from low technology consumer goods, such as food products and light manufactures, to high technology electronic or medical products.

Mitsui & Co., Ltd., for example, put $2 million into Imatron Inc. of South San Francisco, California to help that firm improve its computerized tomography scanners for the Japanese market. A C. Itoh & Co., Ltd. subsidiary has backed the effort of one American firm to develop structural composites; that company, Windecker Inc. of Reno, Nevada, will eventually market products in Japan. Sumitronics Inc., a Sumitomo Corp. subsidiary, has set up a Tokyo office to help American firms to sell their integrated circuit and software design technology.

- The major traders have established subsidiaries dedicated to handling the special needs of high technology products. C. Itoh Technoscience Co., Ltd. and Marubeni Hytech Co., Ltd. are two examples. These smaller offshoots have both the agility and the expertise to adequately support rapidly shifting markets for advanced products. Coupled with the financial and distribution strength of the parent, the arrangement has proved much more effective.

- Efforts to raise the value of traditional lines are also proceeding in a slightly different fashion. The traders are helping to form joint research ventures between Japanese and foreign firms in exchange for trading rights or licenses. Biotechnology has received a great deal of attention, especially in relation to agricultural and medical products. Numerous projects to develop new seed strains or medical tests through biotechnology have been launched. Since both these products are likely to be traded in volume and to require little after-sales support, they are well suited to sogo shosha. Development is also being pursued of special textiles, such as non-woven types, and of metals, including composite-reinforced varieties.

Realignment of traditional lines in non-traditional ways is another strategy. While the need for oil and other raw materials may be on the decline in Japan, it is on the way up in other areas of the world. By adding to or initiating foreign investments, the sogo shosha can use their vast experience to aid foreigners. The process is particularly striking in the steel industry. In cooperation with Japanese steelmakers or alone, sogo shosha are investing in new American processing and service facilities. And in the crude and refined petroleum trade, Marubeni Corp. has opened a second U.S. operation, Pennsylvania Trading International Inc., to service a growing U.S. energy demand.

- The general traders are both following and helping the movement of production facilities out of Japan, particularly into the United States. In response to the numerous automotive plants opened or planned by Japanese makers, the sogo shosha have set up consulting services to help traditional Japanese suppliers relocate. They also have established their own joint ventures (mostly steel service centers and parts distributors). For example, Nissho Iwai Corp., in cooperation with Eagle Industrial Installations Inc., has set up a consulting service for Japanese firms wanting to build U.S. plants. Nissho Iwai also has set up a company to market flexible manufacturing systems in the United States with Yamazaki Mazak Corp.

The sogo shosha are also helping Japanese firms with an established overseas presence to modernize or expand those facilities. In one case, C. Itoh

aided Shima Seiki Manufacturing Co., Ltd. to add the production of computer graphics terminals to activities at its Cranberry, New Jersey plant, which previously turned out only knitting machines.

• Services trade development has also been fine-tuned, although the prospects for many are still unclear.

-- Venture capital is receiving renewed attention, not only for its high returns but also as a window on new technologies. Sumitomo, for example, has invested $2 million in W.R. Grace & Co.'s Grace Venture Partnership II and $1.7 million in Hambro America Inc.'s Hambro International Venture Fund II.

-- Food franchises and restaurants are also current favorites of sogo shosha, targeted both at the Japanese and American markets. Examples include: Mitsui, which has plans for a Japanese chain of fast-food chicken outlets (El Pollo Loco) with Denny's Inc.; Sumitomo, which will bid with Marriott Corp. to provide on-ground and air meal service at the Kansai International Airport now under construction; and Sumitomo, which will help Sushi-Iwa Co., Ltd. to open 50 sushi restaurants in the United States.

-- Leisure services is another area of sogo shosha activity. In an attempt to capitalize on the health/exercise boom that is gripping both Japan and the United States, the general traders are opening athletic and sports clubs in both countries. Resort development and increased imports of sporting goods are other aspects of this thrust.

-- Industrial services are also being promoted, including uniform rental, cleaning and waste management. Although hardly glamorous, this field is highly promising both in Japan and the United States. Training in high technology fields offers another promising area. Boeing Computer Services Co. and Nissho Iwai have an agreement to train Japanese in artificial intelligence engineering. Training will first take place at Boeing's Seattle facilities, but a center in Japan is also planned. Additionally, some of the sogo shosha are venturing into computing services: a C. Itoh subsidiary has added a Cray Research Inc. X-MP to offer supercomputing services to Japanese clients that cannot afford to buy such machines.

• A major commitment to communications is still a part of the strategy. Sogo shosha have shares in several of the new Japanese common carriers and in the consortia servicing Japan's international communications needs. All these ventures face two major problems: too many new entrants may make it impossible for any one of them to win enough customers to be viable, and powerful, entrenched competition -- Nippon Telegraph and Telephone Corp. in the domestic market and Kokusai Denshin Denwa Co., Ltd. for international services -- may prove difficult to overcome. In response, however, general traders are broadening their assault. For the value-added network market, Mitsubishi Corp., in cooperation with IBM Japan Ltd., is developing an on-line transaction processing system that is intended for banks. Mitsubishi's Net One Systems Co., Ltd. subsidiary is also selling U.S. local-area network technology. In the entertainment area, Sumitomo has formed a partnership with Viacom International Inc. to buy and run cable television stations. Mitsubishi and the Seibu Saison Group are bringing the Entertainment Sports Programming Network (ESPN) to Japan, both on the air and by videocassette.

• Sogo shosha also are playing a major role in overseas real estate activity, thanks to the yen's expanded buying power. Although most traders have been active in the field for many years, the pace and the size of their deals have increased dramatically since 1986. After two trial projects, C. Itoh will build several hotels a year in cooperation with Holiday Corp. (Holiday Inns). Mitsui is backing a project with Dorick Development Inc. to construct 164 homes in the San Francisco area. Mitsui is also offering shares in U.S. real estate syndicates through a subsidiary. In addition to providing the usual consulting services (such as Mitsubishi's MIC Consulting Inc., which is centered on the New York city market), the traders are coming up with new ideas. Marubeni has a subsidiary, Estmak Inc., that helps clients find and remodel old New York buildings, such as schools and factories.

• Penetration of the nascent high technology market offers the most interesting twist to the sogo shosha restructuring. One aspect is the funding of leading-edge research and development. Marubeni, for example, has invested $5 million in RPC Industries Inc. along with Fuji Electric Co., Ltd. In a reversal of roles, Fuji is interested in marketing RPC's existing electron beam and ultraviolet industrial curing systems, while Marubeni is interested in developing the technology for use in the food industry. Mitsubishi has brought together NTT and the Battelle Memorial Institute for a project on optical ICs. It is not at all clear if NTT's technology can be brought closer to commercialization in Battelle's Columbus, Ohio laboratories, but it is certainly a noteworthy effort.

To overcome the criticism that they lack high technology experience, sogo shosha are focusing on markets where everyone is starting from scratch. The commercialization of outerspace is a prime target. Nissho Iwai is particularly interested in this area and is establishing relations with the National Aeronautics and Space Administration, Japan's National Space Development Agency and private companies in the field. More immediately, Sumitomo is trying to market United Technologies Corp.'s environmental and life-support systems to NASDA. The general traders are trying to generate excitement about NASA's space station plans, but they realize that the risks are quite high.

Although not truly a nascent industry in Japan, defense and aircraft technology are drawing more interest from the general trading firms. Mitsui and C. Itoh have partnered with Fuji Heavy Industries Co., Ltd. and Kawasaki Heavy Industries Co., Ltd. to produce the V-22 Osprey tilt-rotor aircraft. The craft, combining features of helicopters and conventional airplanes, was developed by Boeing Co. and Bell Helicopter Textron Inc. Mitsubishi is marketing a radar cross-section measuring system developed by System Planning Corp. of the United States.

• Third-country trade will also continue to grow as a share of general trading activities. The logic behind this is simple: although Japan's need for commodities traders may stagnate or decline, demand from other countries will always be present. Why not offer their vast experience and resources to these new clients? Combined with the power to finance deals, the proposition is quite attractive. Sogo shosha hope to play a major role in the development of the Chinese and the Soviet economies as they restructure. They also hope to serve as middlemen as developing countries reach out to new trading partners. The potential for trade between South Korea and Taiwan on the one hand and the Soviet Union and China on the other is certainly there, but the first two barely talk

to the latter pair, much less trade. By acting as an insulator, general trading companies may be able to open entirely new markets.

Back to the Future

In retrospect, it is clear that the sogo shosha strategy for dealing with the strong yen and economic restructuring rests primarily on new slants to traditional activities: trade in low-end consumer goods that can be treated like bulk commodities; creation of sources for these mass goods; investment in new, higher value-added products that complement and extend existing offerings; and use of their experience and resources, which had been gained trading for Japan, to help other countries develop their trade and economies. The only new feature appears to be forays into novel, developing fields.

The success of this "back to the future" strategy rests with the stability of exchange rates and the progress of economic restructuring. If the strong yen is really here to stay, and if the government continues to deregulate and reform institutions, the sogo shosha will have breathing room to learn the ropes. Other factors could also lengthen the adjustment period. The truce between Iran and Iraq has set off speculation about the money to be made rebuilding their war-torn economies. This could spur exports of plant and equipment that have been steadily sinking in the face of competition from South Korea and the stronger yen. Many general traders are expanding their Middle East staff in expectation of orders. The question is whether suitable payment can be arranged -- payment-in-kind with crude oil is not particularly attractive at the moment. Economic reform in the communist world also could revive demand for sogo shosha services, but the political risks are not inconsequential.

When questioned about these new activities, the unanimous opinion of the general traders is that it is too early to tell. They agree that things are not going as well as hoped but add that they are in for the duration. Even if the strategy pans out poorly, the sogo shosha realize that they must continue to try new ideas and approaches. To stand still is to commit suicide.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

JEI Report will not be published September 9, 1988 because of the Labor Day holiday. The next issue will be dated September 16, 1988.

Appendix A: Trade by Type

(In percent of each company's total trade)

Fiscal Year	Domestic	Exports	Imports	Third Country
a. C. Itoh & Co., Ltd.				
1983	45.8%	16.3%	18.8%	19.1%
1984	44.0	18.1	18.3	19.6
1985	44.5	18.6	16.6	20.3
1986	55.3	17.9	9.9	16.9
1987	55.6	14.3	10.8	19.3
b. Mitsubishi Corp.				
1981	38.1	18.4	32.0	11.5
1982	37.0	18.5	33.6	10.9
1983	36.0	17.0	33.1	13.9
1984	35.6	16.5	32.0	15.9
1985	38.7	15.5	27.9	17.9
1986	46.3	17.6	19.7	16.4
1987	45.1	17.0	19.5	18.2
c. Sumitomo Corp.				
1980	32.0	21.4	16.6	10.0
1981	50.0	26.3	15.3	8.4
1982	49.8	25.8	15.8	8.6
1983	49.3	23.7	16.4	10.6
1984	48.9	21.2	17.2	12.7
1985	46.5	21.5	20.8	11.2
1986	48.1	23.7	18.1	10.1
1987	50.4	21.0	18.1	10.7
d. Mitsui & Co., Ltd.				
1980	39.0	18.0	22.0	21.0
1981	38.0	21.0	21.0	20.0
1982	36.0	20.0	24.0	20.0
1983	35.0	17.0	25.0	23.0
1984	33.0	17.0	24.0	26.0
1985	34.0	17.0	22.0	27.0
1986	40.0	21.0	16.0	23.0
e. Marubeni Corp.				
1981	36.0	26.4	19.0	18.6
1982	35.4	28.8	19.9	16.0
1983	34.5	28.3	19.7	17.5
1984	33.3	26.1	21.2	19.4
1985	33.6	24.9	20.2	21.3
1986	39.0	22.4	15.0	23.6
f. Nissho Iwai Corp.				
1981	37.4	18.1	27.4	17.1
1982	33.7	17.8	26.0	22.5
1983	34.6	16.0	27.2	22.2
1984	32.5	15.5	28.1	23.9
1985	31.3	14.5	28.4	25.8
1986	35.1	12.7	30.4	21.8
1987	33.0	9.2	30.3	27.6

Source: Company annual reports.

Appendix B: Trade by Commodity Group

(in percent of each company's total trade)

a. C. Itoh & Co., Ltd.

Fiscal Year	Machinery	Metals	Chemicals and Energy	Textiles	Food Products	Other
1983	21.9%	14.6%	32.8%	12.7%	13.3%	4.8%
1984	24.8	14.5	32.0	12.4	12.0	4.6
1985	28.1	14.0	30.1	11.6	11.5	4.8
1986	32.8	18.2	19.5	12.3	11.8	5.4

b. Mitsubishi Corp.

Fiscal Year	Machinery	Metals	Chemicals	Energy	Food Products	Other
1981	19.8	22.6	8.1	26.8	14.2	8.5
1982	21.3	22.2	8.0	26.9	13.7	7.9
1983	19.1	21.6	8.1	28.7	15.0	7.5
1984	19.0	21.1	8.1	30.8	13.8	7.2
1985	21.1	21.4	8.0	29.9	12.5	7.2
1986	29.0	22.9	8.8	16.1	14.2	9.0

c. Sumitomo Corp.

Fiscal Year	Machinery	Metals	Chemicals and Energy	Textiles	Food Products	Other
1980	24.3	29.6	28.0	2.4	6.7	9.0
1981	26.8	30.4	25.8	2.2	6.6	8.2
1983	28.1	29.6	24.7	2.3	6.9	8.4
1984	28.7	29.7	24.5	2.2	6.6	8.3
1985	29.5	30.5	24.4	2.5	6.3	8.1
1986	33.4	32.8	16.5	2.6	6.3	8.4

d. Mitsui & Co., Ltd.

Fiscal Year	Machinery	Metals	Chemicals and Energy	Textiles	Food Products	Other
1980	15.0	27.0	27.0	4.0	19.0	8.0
1981	18.0	26.0	28.0	4.0	16.0	8.0
1982	18.0	21.0	30.0	4.0	17.0	7.0
1983	16.0	23.0	33.0	4.0	18.0	6.0
1984	16.0	24.0	37.0	3.0	15.0	6.0
1985	18.0	25.0	35.0	4.0	12.0	6.0
1986	21.0	30.0	24.0	4.0	14.0	7.0

e. Marubeni Corp.

Fiscal Year	Machinery	Metals	Chemicals and Energy	Textiles	Food Products	Other
1981	25.3	20.4	24.7	8.8	14.6	6.2
1982	29.1	19.0	23.6	9.2	12.9	6.2
1983	27.5	19.2	25.8	9.2	11.7	6.7
1984	29.2	17.5	26.3	8.8	11.7	6.6
1985	28.7	18.2	27.3	9.1	10.5	6.3
1986	28.0	19.7	25.0	10.6	10.6	6.8

f. Nissho Iwai Corp.

Fiscal Year	Machinery	Metals	Chemicals and Energy	Textiles	Food Products	Other
1981	19.4	31.6	27.1	5.6	7.9	8.4
1982	21.3	28.8	28.8	5.3	7.4	8.4
1983	19.6	28.9	24.5	5.2	7.3	14.5
1984	19.1	29.3	26.2	5.0	7.3	13.1
1985	18.0	29.5	28.5	4.6	7.2	12.2
1986	16.5	37.8	21.2	5.2	7.2	12.1

Source: Company annual reports.

NOTE

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